

**Internal Revenue Service  
Appeals Office**

Release Number: 201313035  
Release Date: 3/29/2013  
Date: December 5, 2012

**Department of the Treasury**

**Taxpayer Identification  
Number:**

\*\*\*\*

**Person to Contact:**

\*\*\*\*

**Tax Period(s) Ended:**

\*\*\*\*

**UIL: 0501.07-01**

\*\*\*\*

\*\*\*\*

\*\*\*\*

**Certified Mail**

Dear \*\*\*\*:

We considered your appeal of the adverse action proposed by the Director Exempt Organizations. Although not recognized by the Internal Revenue Service as an exempt organization under section 501(a) of the Internal Revenue Code (the "Code"), your organization filed Form 990 for years ending \*\*\*\*, \*\*\*\* and \*\*\*\*.

This is our final determination that you do not qualify for the claimed tax exempt status from federal income tax under section 501(a) of the Code as an organization described in either section 501(c)(7) of the Code or section 501(c)(4) of the Code. There is no time period during which \*\*\*\* was an organization exempt from federal income tax under section 501(a) of the Code as an organization described in either section 501(c)(7) or section 501(c)(4).

Our adverse determination was made for the following reason(s):

Because your primary activity is the operation of a restaurant for members of the general public, you have failed to meet the requirements for exemption of Section 1.507(c)(7)-1(b) of the Federal Tax Regulations which provides that a club which engages in business, such as making its social and recreation facilities available to the general public, is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, and is not exempt under section 501(a).

Furthermore, you are not exempt under 501(a) of the Code as a social welfare organization described in section 501(c)(4) of the Code because section 1.501(c)(4)-1(a)(2)(ii) of the Federal Tax Regulations provides that an organization is not operated primarily for the promotion of social welfare if its primary activity is carrying on a business with the general public in a manner similar to organizations which are operated for profit.

You are required to file Federal income tax returns on Forms \*\*\*\* for the tax periods stated in the heading of this letter and for all tax years thereafter. File your return with the appropriate Internal Revenue Service Center per the instructions of the return. For further instructions, forms, and information please visit [www.irs.gov](http://www.irs.gov).

Please show your employer identification number on all returns you file and in all correspondence with Internal Revenue Service.

You also have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States Court. The Taxpayer Advocate can however, see that a tax matters that may not have been resolved through normal channels get prompt and proper handling. If you want Taxpayer Advocate assistance, please contact the Taxpayer Advocate for the IRS office that issued this letter. You may call toll-free, 1-877-777-4778, for the Taxpayer Advocate or visit [www.irs.gov/advocate](http://www.irs.gov/advocate) for more information.

If you have any questions about this letter, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely Yours,

/s/  
Appeals Team Manager

CC: \*\*\*\*



**TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION**

**DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
575 N. Pennsylvania St.  
Stop GE 750  
Indianapolis, IN 46204-1526**

**LEGEND:**

**ORG – Organization name  
Address – address  
XX – Date**

**ORG  
ADDRESS**

**Date: June 21, 20XX**

**Taxpayer Identification Number:  
Form:  
Tax Period(s) Ended:  
Person to Contact/ID Number:  
Contact Numbers:  
Telephone:  
Fax:**

**CERTIFIED MAIL – Return Receipt Requested**

**Dear**

During our examination of the return(s) indicated above, we determined that your organization was not described in Internal Revenue Code section 501(c) for the tax period(s) listed above and, therefore, it does not qualify for exemption from federal income tax. This letter is not a determination of your exempt status under section 501 for any period other than the tax period(s) listed above.

The attached Report of Examination, Form 886-A, summarizes the facts, the applicable law, and the Service's position regarding the examination of the tax period(s) listed above. You have not agreed with our determination, or signed a Form 6018-A, Consent to Proposed Action, accepting our determination of nonexempt status for the period(s) stated above. You have not agreed to file the required income tax returns. You may appeal your case. The enclosed Publication 3498, *Exempt Organizations Appeal Procedures for Unagreed Issues*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

If you request a conference with Appeals, you must submit a written protest within 30 days of the date of this letter. An Appeals officer will review your case. The Appeals Office is independent of the Director, EO Examinations. Most disputes considered by Appeals are resolved informally and promptly.

You may also request that we refer this matter to IRS Headquarters for technical advice as explained in Publication 892. If you do not agree with the conclusions of the technical advice memorandum, no further administrative appeal is available to you within the IRS examination.

If we do not hear from you within 30 days of the date of this letter, we will issue a Statutory Notice of Deficiency based on the adjustments shown in the enclosed report of examination.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

In the future, if you believe your organization qualifies for tax-exempt status, and would like to establish its status, you may request a determination from the IRS by filing Form 1024, Application for Recognition of Exemption Under Section 501 (a), and paying the required user fee.

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing  
Director, EO Examinations

**Enclosures:**  
**Publication 892**  
**Publication 3498**  
**Form 6018-A**  
**Report of Examination**  
**Envelope**

Form  
886-A

U.S. Treasury Department-Internal Revenue Service  
**EXPLANATION OF ITEMS**

Schedule No. or  
Exhibit

Name of Taxpayer  
ORG

Year/Period Ended  
12/31, 20XX & 20XX

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**Legend:**

ORG - Organization Name

X - Number

PERSON 1, 2, 3 - Individuals

\$ - Dollar Amount

LAW - Ordinance

DAY - Day of the Week

ENTITY 1, 2 - Unrelated Entities

COUNTY - County Name

PARTY - Political Party

POA - Power of Attorney

FOR-PROFIT ENTITY - For-Profit Entity

FORM - Tax Form

Form  
886-A

U.S. Treasury Department-Internal Revenue Service  
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Schedule No. or  
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Name of Taxpayer  
ORG

Year/Period Ended  
12/31, 20XX & 20XX

**ISSUE**

Should the ORG be treated as an organization described in 501(c)(7)?

**FACTS**

The calendar years ended (CYE) December 31, 20XX, 20XX and 20XX are under examination.

The Articles, dated July XX, 20XX, state the legal name as the "ORG, ""

The purpose of the ORG is in the Articles of Incorporation (Articles). The purpose is to establish, maintain and conduct a ORG for the social enjoyment, leisure and recreation of the members; to encourage and promote interest in understanding the importance of the civil liberties enjoyed by all Americans; to further the education of its members regarding the historical background of the United States; and to promote participation of its members in the processes of local, state, and federal legislative bodies.

Upon dissolution, the Articles state the remaining assets shall be transferred by the Board of Directors to the equity members.

The ORG has not received a determination letter recognizing exempt status under 501(a). The ORG has filed Forms 990, Return of Organization Exempt From Income Tax for the years under examination to be "treated" as a tax-exempt social ORG described in 501(c)(7). The ORG also filed Form 990-T, Exempt Organization Business Income Tax Return for CYE 20XX and 20XX.

Form 990	<u>12/31/20XX</u>	<u>12/31/20XX</u>	<u>12/31/20XX</u>
Dues	\$	\$	\$
Investment income			
Gross Sales			
Cost of Goods			
Total Expenses			
Total Revenue	\$	\$	\$

  

Form 990-T	<u>12/31/20XX</u>	<u>12/31/20XX</u>
Gross Receipts	\$	\$
Taxable Income		
Advertising Expense	\$	\$

Form  
886-A

U.S. Treasury Department-Internal Revenue Service  
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The Forms 990 and 990-T for all years report the ORG's primary activity is food services provided to members. The Forms 990 also list PERSON 1 as the President, PERSON 2 as the Vice-President and Treasurer and PERSON 3 as the Secretary and Manager.

The Bylaws state the ORG" ...shall be managed by a Board of two (2) directors, which shall include the four (3) [sic] officers of President, Secretary and Treasurer..."

The Bylaws list two classes of members known as equity and social members. Equity members are persons having contributed cash or other property to the corporation. Paying capital into the ORG for day-to-day operating purposes also qualifies one as an equity member. Social members, by paying annual dues and periodic assessments, have the right to participate in general ORG activities but have no voting power. The Articles or Bylaws do not require membership requirements of the social membership class.

The ORG conducts regular meetings. The topics listed in the minutes include: 1) the effect of the municipal government's LAW on the ORG; 2) the catering business; 3) the use of the ORG by other organizations; 4) the publishing of a newsletter and 5) allowing for the nomination and election of a social membership representative. The minutes make no reference to an activity furthering the members' involvement or interest in a hobby, sport, common interest or pursuit.

The minutes make reference that the ORG's facility is used by other organizations in the community. The local ENTITY 1 uses the ORG's facility for meetings on the X and X DAY of each month. The ORG provides a meal to ENTITY 1 charging \$ for each meal provided to the X (or so) ENTITY 1's members in attendance. ENTITY 2 has sponsored a fund raiser using the ORG and the COUNTY PARTY held a meeting of the candidates event at the ORG.

PERSON 1 and PERSON 2 and the Power of Attorney, POA were present during the initial interview. It was stated by the officers the purpose of the ORG is to provide a sense of home for the elderly and provide a place for the members to discuss events, etc.

The officers stated the ORG operating hours are - X am - X pm  
- X am - X pm on DAY  
- X am - X pm on DAY and DAY

The restaurant is open for business during these operating hours.

The officers stated the social members pay \$ a year in membership dues. The ORG has X social members and X equity members. Upon entering the ORG a person pays \$ and becomes a member. In fact, upon entering the ORG the IRS Agent writing this report was solicited to pay \$ and become a member. The equity members are PERSON 1 and PERSON 2.



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The officers stated the ORG activities include member discussions, which occur at will during the normal hours of operation. The ORG will be open past normal operating hours when a significant event is held in the community. Activities related to the members' involvement in a hobby, sport, common interest or pursuit are not conducted.

Inspecting the ORG revealed it is a restaurant operation and catering facility. The minutes verify bids were accepted for the catering services.

The building being used by the ORG is owned by FOR-PROFIT ENTITY. A written lease agreement was executed between the ORG and FOR-PROFIT ENTITY. The term of the lease is for one year beginning August 1, 20XX. At the end of the term the lease will be month-to-month. The ORG shall pay \$ per month in rent. Occupancy expenses totalling \$, \$ and \$ were reported on the CYE 20XX, 20XX and 20XX Forms 990 respectively.

The ORG is embroiled in a legal dispute with the local government about a LAW. The local government claims the LAW applies to the ORG. The ORG claims the LAW does not apply and has taken the matter to court to have the issue resolved.

#### LAW

Code section 501(a) grants exemption from taxation to organizations described in Code section 501(c).

Code section 501(c)(7) describes social clubs as being organized for pleasure, recreation or other nonprofitable purposes, substantially all of the activities of which are for such purposes and no part of the net earnings of which inures to the benefit of any private shareholder.

Income Tax Regulation section (Regulation) 1.501(c)(7)-1(a) states "The exemption provided by section 501(a) for organizations described in 501(c)(7) applies only to clubs which are organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, but does not apply to any club if any part of its net earning inures to the benefit of any private shareholder. In general, this exemption extends to social and recreational clubs which are supported solely by membership fees, dues and assessments. However, a club otherwise entitled to exemption will not be disqualified because it raises revenue from members through the use of club facilities or in connection with club activities."

Regulation section 1.507(c)(7)-1(b) states in part "A club which engages in business, such as making its social and recreation facilities available to the general public or by selling real estate, timber or other products is not organized and operated exclusively for pleasure, recreation and other nonprofitable purposes, and is not exempt under 501(a)."

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Revenue Ruling 58-588, 1958-2 CB 265 states in part that a club "...whose prominent activity is the selling of services for profit to an unlimited number of so-called "members", who have no voice in the management of the club and whose only rights are to the use of the club's facilities upon the payment of specified fees, is not a tax-exempt social club within the meaning of section 501 (c)(7)..."

Revenue Ruling 58-588 continues by stating "On the basis of the information presented, it is concluded that the club in the instant case is operated in the personal interest of a few individuals; that social features are not a material purpose of the club but are subordinate and merely incidental to the active furtherance of a predominant purpose to engage in the business of selling services for profit to an unlimited number of individuals termed "associate members;" that "associate" membership is not a true membership but is merely a guise under which virtually unlimited numbers of individuals may utilize the club facilities; and that income from associate members is in reality income from transactions with the general public."

Revenue Ruling 58-588 also states that "Solicitation by advertisement or otherwise for public patronage of its facilities is prima facie evidence that the club is engaging in business and is not being operated exclusively for pleasure, recreation, or social purposes."

Revenue Ruling 58-589, 1958-2CB 266 states in part that " ...to qualify for income tax exemption, a social club should not advertise its facilities for nonmember patronage since this would be prima facie evidence it was engaging in business."

Revenue Ruling 66-179, 1966-1 CB 139, Situation 4 addresses a garden club qualifying under section 501(c)(7) of the Code. "The organization was incorporated by amateur gardeners to promote their common interest in gardening. The organization (1) holds flower shows and exhibits to display members' achievements in home gardening, (2) schedules weekly meetings devoted primarily to informal social hours during which matters related to gardening are discussed, and (3) issues a publication containing news about members' social activities and achievements in home gardening. Its funds are derived from membership dues, fees, and assessments. No part of the net earnings of the organization inures to the benefit of any officer or member."

Revenue Ruling 67-139, 1967-1 CB 129, Situation 2.-- club qualifying under section 501(c)(7) of the Code. "The club was formed by mineralogy and lapidary enthusiasts to disseminate knowledge of mineralogical and lapidary subjects, to promote their application so that greater pleasure may be derived from these activities, and to promote good fellowship among its members. In furtherance of these purposes, the club (1) holds monthly social meetings during which the members discuss gem and mineral topics and sell, purchase, or exchange rock and mineral specimens; (2) issues a bulletin containing news of members' social activities and their rock and mineral collections; and (3) annually conducts a show for the general public at which its members display their lapidary techniques and mineral specimens. A nominal admission fee,

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designed to cover expenses of the show, is charged for admittance to the show. The club's funds are otherwise derived solely from membership dues, fees, and assessments. No part of the net earnings of the organization inures to the benefit of any individual."

Revenue Ruling 67-139 also states that "The club provides a meeting place for its members where they may associate with each other and become more proficient in their hobbies. It is operated primarily to accommodate its members in their recreational pursuits. The gem and mineral show serves to stimulate the members' hobby interests and is, thus, consistent with the society's recreational purposes."

Revenue Ruling 69-635 1, 1969-2 CB 126 states that "An automobile club whose principal activity is rendering automobile services to its members but has no significant social activities does not qualify for exemption under section 501(c)(7) of the Code..."

Revenue Ruling 74-30, 1974-1 CB 137 A flying club of limited membership that provides flying privileges solely for its members, assesses dues based on the club's fixed operating costs and charges fees based on variable operating expenses, and whose members are interested in flying as a hobby, constantly comingle in informal meetings, maintain and repair the aircraft owned by the club, and fly together in small groups qualifies for exemption under section 501(c)(7) of the Code.

#### **GOVERNMENT'S POSITION**

The ORG does not conduct activities furthering the members pursuit of a common recreational interest. Therefore, the ORG should not be treated as a social club described in Code section 501(c)(7) for the years under examination.

To be treated as a social club, the ORG must: 1) be a club; 2) be organized for pleasure and recreation; 3) have substantially all activities devoted to recreational purposes; 4) ensure no inurement is provided to any private shareholder; and 5) not have a written discrimination policy.

Code section 501(c)(7) does not define the term "club". However, a club must have certain characteristics including: 1) the membership of individuals; 2) personal contact; 3) comingling of the membership; 4) fellowship among members; 5) members sharing some active interest and; 6) the sharing of goals by members justifying the existence of a club.

The exemption of social clubs is based on the members pooling their funds for recreational purposes rather than a compelling public benefit. A social club must be organized and operated for pleasure, recreation and other nonprofitable purposes. The receipts must be generated from the pursuit of the common interest devoted to pleasure, recreation and other nonprofitable purposes.

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**Purpose of the ORG**

The Articles state the purpose of the ORG is to provide for the social enjoyment of its members and educating members on the importance of the civil liberties enjoyed by the citizens of the United States. This purpose does not meet 501(c)(7) requirements. Educating the membership on the importance of civil liberties is not a 501(c)(7) purpose.

The stated purpose does not list a common interest providing for the social enjoyment and comingling of the members. The purpose does not list an active interest or sharing of goals by the members justifying the existence of the ORG. The ORG isn't organized for pleasure or recreation. The ORG's purpose does not provide for recreation and comingling of the membership around a common interest.

The Government's position is that the ORG's purpose does not comply with 501(c)(7).

**Membership**

The two classes of membership consist of two (2) equity members and an unspecified number of social members.

Membership qualifications related to the pursuit of a common interest are not found in the Bylaws or Articles. Stating qualifications for membership in the organizing documents ensures the persons solicited for membership share the interest of the members. The organizing documents state the ORG's social membership includes any individual who has paid their dues and any assessments. Such persons are accepted into the social membership.

The membership requirements do not meet the standard set by 501(c)(7). The ORG's members pay annual dues of \$ and there are no formal membership requirements. Membership is available to all entering the ORG's restaurant. Indeed, upon entering the ORG, the IRS Agent writing this report was solicited to pay \$ and become an ORG member. The Government's position is that the ORG's membership is, in fact, the general public. The low dues, no membership requirements and membership being available simply by entering the ORG and paying \$ provides clear evidence that the ORG's social membership class is the general public. The social membership designation is not a true membership but is a guise under which virtually unlimited numbers of individuals may use the ORG's restaurant facility.

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Also, the lack of substantive membership requirements is clear evidence that there is no common interest shared by the membership. Membership is open to all members of the public thus negating the requirement of the members common interest.

### Activities

A social club as defined by 501(c)(7), shall provide a meeting place for persons interested in a hobby, sport or some form of active recreational interest common to the members. Then a viable social club sponsors activities related to the members' pursuit of this common interest. Then receipts from the members are generated from conducting these activities, thus providing the members' wherewithal to pursue their interests. Such is not the case with the ORG. The activities of the ORG do not support a 501(c)(7) purpose.

The Government's position is the ORG does not sponsor activities devoted to pleasure, recreation or nonprofitable purposes related to the pursuit of a common interest. Enjoying conversation while dining does not meet 501(c)(7) requirements. The ORG is providing a service to its membership by operating a full-time restaurant which does not provide the social activities required by 501(c)(7). Therefore, the ORG may not be treated as a 501(c)(7) social ORG for all years under examination.

The restaurant is open during the normal operating hours of the ORG making it the exclusive activity of the ORG. No other activity is conducted during normal operating hours. While dining may be a part of a viable social club's activities it may not be the exclusive activity. Dining in the company of another person is pleasurable. However, dining is not an activity meeting the requirements of a social club within 501(c)(7). If it were, any restaurant would qualify as a social club.

The ORG has regular meetings attended by the equity members and two social members. The subjects discussed involve the operation of the restaurant and catering services, publishing a newsletter, use of the club facility by other organizations and the municipal LAW. The minutes contain no references to planning or conducting activities devoted to the pleasure of the membership. This verifies the activities are not devoted to social or recreational pursuits. Meetings of a viable social club are devoted to planning activities in pursuit of the common interest or hobby shared by the membership. In fact, the meeting should be a social and recreational activity for the membership, but the ORG has only two social members attending the meetings. The ORG's meetings are devoted to the operation of the restaurant, catering facility and addressing the LAW. The meetings do not provide a forum for the membership to plan activities involving a common recreational interest. The minutes provide evidence of not complying with 501(c)(7).

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The ORG may argue that the restaurant activity provides a place where the members may sit, eat a meal and discuss the civil liberties enjoyed in the United States or other subjects related to responsible citizenship. The Government's position is that conversations while dining are pleasurable. However, the ORG's primary purpose is the rendering of a service to the membership which is not in compliance with 501(c)(7) requirements. Also, conversations while dining is not a pleasurable activity within the scope of 501(c)(7).

The ORG is performing an activity similar to Revenue Ruling 58-588. The ORG's exclusive activity is the selling of a food service to the members. This service is not related to a hobby, sport or active interest which all members have in common.

The ORG is open during community events such as election days. Prior to an election the ORG may be used by candidates to communicate with the residents of the community and members. These events provide a service to the community and an element of pleasure may be associated with them. However, this does not further the social and recreational requirements of 501(c)(7). These activities are more indicative of a 501(c)(4) social welfare organization and, in fact, don't involve the pursuit of a common recreational interest of the membership required by 501(c)(7).

Local organizations use the ORG facilities as a meeting place. At each meeting, the ORG provides a meal to one of these organizations at a per plate cost. While this may serve the interests of the entity using the ORG's facility, it does not further the ORG's requirement of being substantially devoted to recreational activities required of a 501(c)(7) social club.

Receipts should be generated from activities related to the pursuit of a common recreational interest shared by the members. By generating receipts from the pursuit of a common interest, the members are pooling their funds to promote the enjoyment of their common interest. The ORG is generating revenue from a food service provided to the membership, and this is stated on the Forms 990 and 990-T for the years under examination. Therefore, the ORG is not operated solely on membership fees, dues and assessments. Revenue is not generated through the use of the ORG facility in connection with ORG activities. Income from social members is, in reality, income from the general public.

The Government's position is that the social features are not material but are subordinate to the active purpose of selling a product to an unlimited number of persons designated as social members who are, in fact, the general public. Therefore, the ORG should not be treated as a 501(c)(7) social club. The activities don't comply with the requirements of 501(c)(7).

#### Voting

The Bylaws state the equity members have voting privileges to determine the ORG's management, operation and control. The Bylaws state the social members do not have voting privileges. The Government's position is that the organizing documents of a viable social club

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would give its members a voice in the control of the club. This ensures the members are actively involved in the pursuit of their common pleasurable interest.

Denying social members voting privileges clearly indicates the ORG is not organized for the pleasure of the membership. The social members have no voice in the affairs of the ORG. Therefore, the ORG is not entitled to be treated as a 501(c)(7) social club.

#### Advertising

The ORG advertises for public patronage of its facilities. This is evidence that the ORG is engaging in business and is not being operated for pleasure, recreation or social purposes.

#### TAXPAYER'S POSITION

The taxpayer does not agree with the Government. The taxpayer believes the ORG complies with the requirements of 501(c)(7). The ORG should be allowed to file Form 990 and be treated as a 501(c)(7) social club.

#### CONCLUSION

The ORG's Articles and Bylaws indicate the ORG is not organized for the members' pleasure or recreation. The ORG's activities do not further a social or recreational purpose. The ORG operates what would be classified as a for-profit restaurant and catering facility. The ORG's restaurant operation is providing a personal service to the general public. Therefore, the ORG is not operated for the members' pleasure or recreation. Finally, the ORG is not organized or operated as a social club within the meaning of 501(c)(7).

The Government's position is that the ORG is operated in a manner consistent with any for-profit restaurant business. The ORG is doing business with the public which is inconsistent with the term "club" as used in 501(c)(7).

The ORG should not be treated as a social club within the meaning of Code section 501(c)(7). The ORG has Articles making it a corporate entity. Therefore, the ORG must file FORM, for CYE 20XX, 20XX, 20XX and all subsequent years.